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TESTIMONY BEFORE THE SENATE BUDGET COMMITTEE
TREASURY SECRETARY PAUL H. O'NEILL

Good morning, Chairman Domenici, Senator Conrad and members of the Committee. It's a pleasure to be here with you today.

President Bush unveiled his budget this morning, and it is full of good news for the American people. First, it funds America's priorities, especially in education. Second, it walls off every dollar of the Social Security surplus and proposes Medicare reform to strengthen retirement security for every generation. And finally it reduces individual income taxes, to eliminate the structural overtaxation that has created a tax surplus today.

There's no question that the numbers in the federal budget are enormous. We are proposing \$1.9 trillion in government spending for next year alone. For the next 10 years, total spending will be over \$22 trillion. These are changes of an entire order of magnitude since the last time I served in Washington. In fact, this year's projected budget surplus of \$281 billion is almost as large as the total on-budget government spending in my last year of service in Washington. That's evidence of how much our economy has grown, and how much Washington has grown.

The federal budget surplus is projected to be \$5.6 trillion over the next ten years. And this is a fairly conservative estimate, given that we've underestimated the surplus several years in a row now. Even after setting aside the Social Security surplus, there is plenty of room for a \$1.6 trillion tax cut. The numbers are big, but the math is fairly simple: Start with the \$5.6 trillion surplus, take away \$2.6 trillion in Social Security surplus and \$1.6 trillion for tax relief, and we are left with a \$1.4 trillion cushion to address our priorities - beginning with Medicare reform, to service the debt, and to be prepared for unexpected needs.

This is a fiscally prudent budget. Under this plan, we will pay off a large portion of the publicly held debt over the next six years. Washington ran deficits instead of surpluses for so long that no one gave much serious thought to the prospect of retiring our debt instruments before they mature. Only now, as we face the reality of rapidly mounting surpluses, are we confronted with serious questions about the potential impact of buying back the publicly held debt from a public that may not be willing to sell it all back early.

The debt held by the public will amount to \$3.2 trillion at the end of this year. Retirement funds, state and local governments and foreign investors all have come to rely on the security of U.S. Treasuries. It could be very costly - if not impossible - to retire all of those holdings prematurely. Moreover, there needs to be a replacement opportunity for them. Experts are already thinking about alternatives to Treasury Securities for use by the Federal Reserve and others, but these are novel concepts that will take time to put in place.

In addition to systemic adjustment questions, there are cost questions related to paying off the entire publicly held debt. In testimony before the Senate Budget Committee, Fed Chairman Alan Greenspan explained it this way: "some holders of long-term Treasury securities may be reluctant to give them up, especially those who highly value the risk-free status of those issues. Inducing such

holders, including foreign holders, to willingly offer to sell their securities prior to maturing could require paying premiums that far exceed any realistic value of retiring the debt before maturity.”

Under the assumptions supporting the President’s plan, we pay off all but this “non-retireable” debt by 2008. While we are paying off the retireable debt, the plan also increases spending on education next year by 11 percent, increases defense spending next year by \$14 billion, and provides \$661 billion in overall discretionary spending next year. Discretionary spending will increase by 4 percent, more than enough to account for inflation and address real needs.

Some want to increase spending even further. We disagree. Instead of simply piling on new spending, we must be better stewards of the taxpayers’ dollars. We have overlapping programs throughout the government with little or no information on how well they deliver services to the taxpayers. We need to find out where we are getting results and where we aren’t, and adjust federal spending accordingly.

Once we’ve paid down the debt that can be retired, walled off Social Security funds where they can’t be drained for other government spending, and increased spending for America’s priorities, we face the question of how to use any additional surplus dollars. If they aren’t returned to the taxpayers, they can only be spent in Washington, creating new government programs or buying up private assets. Government is big enough, and it has no business owning private companies.

People make better decisions than government about how to spend their money. That’s why we must eliminate structural overtaxation and let people keep more of what they earn.

Today the federal individual income tax burden is higher than at any other time in our nation’s history. We have no business taking from taxpayers more than it costs to pay for agreed public purposes.

The President has proposed tax relief that reinforces the values that make America great – opportunity, entrepreneurship, strong families and individual success.

First, the President has proposed reducing income taxes for every American who pays income taxes. The current five rate system will be simplified to four rates, and the tax rate on the first \$6,000 of taxable income earned by every American will fall from 15 to 10 percent.

High income tax rates block access to the middle class for working Americans struggling to get ahead. And high income tax rates punish success. We must have a tax code that keeps the American Dream in everyone’s reach and helps people move up the economic ladder of success. We must have a tax code that fosters entrepreneurship and does not penalize hard work.

Cutting income tax rates is the most effective fiscal policy action we can take to put our economy back on the path of long-term economic growth. The best minds in this nation contain incredible knowledge and creativity. If we work together to unleash that potential, we can achieve permanent high rates of growth that will make all our other goals more achievable.

The President’s tax relief plan also strengthens the ties that hold families together.

- It doubles the child tax credit to \$1,000 per child. Parents everywhere have one goal above all others: to give their children the best possible opportunity for success and happiness in life. The

increased child tax credit will give parents more resources to save for college tuition, pay for braces or hire a tutor.

- This plan also reduces the unfair marriage penalty. We as a society celebrate when two people decide to spend their lives together. Why would our tax code punish them?
- And this plan eliminates the unfair death tax. Government has no business confiscating the legacy parents work their entire lives to build for their children.

This package is a pay raise for working Americans. Four-person families earning \$35,000 a year will no longer bear any federal income tax burden. Four-person families earning \$45,000 will see their income taxes cut in half. And four-person families earning \$75,000 will see their income tax burden reduced by 22 percent.

The President's tax relief plan maintains the progressivity of our tax code – and, in fact, increases the share of federal income taxes paid by upper-income taxpayers. In 1998, the top 10 percent of income earners paid 65 percent of federal income taxes, while the bottom half of income earners paid 4.2 percent of the total federal income tax burden. After implementing the President's tax relief plan, the top 10 percent of income earners will pay 66 percent of all federal income taxes. The average family will keep \$1,600 a year that they would otherwise have sent to Washington. That's enough for two monthly mortgage payments or for a year of junior college tuition.

Taxpayers in the higher tax brackets are likely to invest their tax relief in the economy, creating jobs for all Americans. Small businesses are the engine of growth in our economy, and a majority of small businesses pay taxes under the individual income tax system. A small businessman receiving tax relief will plow that back into the firm, either to increase productivity, which results in higher wages, or to hire more workers. A farmer will be able to use his tax savings to trade in his old tractor and purchase the newest technology to improve his crop yield. America's economy will grow as these investments go forward.

This tax relief package is sound fiscal and economic policy. It fits easily within our budget framework, leaving a \$1.4 trillion cushion over the next ten years to service the debt, to address priorities – beginning with Medicare reform, and to handle unexpected needs. I like to refer to it as the Goldilocks tax relief plan – not too big, not too small, just right.

This budget strengthens the three platforms that make success and prosperity possible for all generations of Americans – improved education, fiscal responsibility, and tax fairness. I look forward to working with the members of this committee to implement these common sense budget priorities, so that America continues to lead the world toward greater freedom and opportunity.

Thank you.